

## Internal Revenue Service

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-108418-10

Date:

September 08, 2010

### Legend

Company =

State =

Date 1 =

Date 2 =

Entities =

Year =

A =

B =

C =

Dear :

This letter responds to a letter dated February 15, 2010, and subsequent correspondence, submitted on behalf of Company by Company's authorized representative, requesting a ruling that rental income received by Company is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

### Facts

Company was incorporated under the laws of State on Date 1, and elected under § 1362(a) to be an S corporation effective Date 2. Company owns, leases, and manages commercial rental real estate. In addition, Company owns an interest in Entities all of whom own, rent, and operate commercial office and industrial buildings and apartment and multi-family residential buildings. Company is actively involved in the management of each of the Entities. None of the Entities have hired employees or other management companies to handle the day-to-day business of operating the properties owned by them.

With respect to the wholly-owned properties, Company is actively involved in performing all of the leasing and administrative functions for maintaining the properties, including repair and maintenance services. Company has A employees and multiple independent contractors involved in the day-to-day activities associated with its commercial real estate.

With respect to each of the properties owned by the Entities, Company performs varying services. For example, Company may be responsible for management, financing, tenant negotiations, cash flow decision making, remodeling decisions, lease approval and negotiations, major development approval, mortgage and sale negotiations, advertising, repairs and maintenance, capital improvements, services for snowplowing, lawn care, trash removal, overseeing construction, and bookkeeping.

For the tax year ending in Year, Company collected approximately \$B in gross rents and paid or incurred approximately \$C in relevant operating expenses (other than

depreciation).

Company represents it has accumulated earnings and profits.

### Law and Analysis

Section 1362(a)(1) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(3)(A)(i) provides that an election under § 1362(a) shall be terminated whenever the corporation (1) has accumulated earnings and profits at the close of each of three consecutive taxable years, and (2) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income.

Section 1362(d)(3)(C)(i) provides that, except as otherwise provided in § 1362(d)(3)(C), the term “passive investment income” means gross receipts derived from royalties, rents, dividends, interest, and annuities.

Section 1.1362-2(c)(5)(ii)(B)(1) of the Income Tax Regulations provides that “rents” means amounts received for the use of, or right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that “rents” does not include rents derived in the active trade or business of renting property. Rents received by a corporation are derived in the active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including, but not limited to, the number of persons employed to provide the services and the types and amounts of costs and expenses incurred (other than depreciation).

### Conclusion

Based solely on the facts submitted and representations made, we conclude that the rental income Company receives from its operations described above is not passive investment income under § 1362(d)(3)(C)(i).

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding Company's eligibility to be an S corporation. Further, the passive investment income rules of § 1362 are

independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, we are sending a copy of this letter to your authorized representative.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the ruling request, it is subject to verification on examination.

Sincerely,

/s/

Tara P. Volungis  
Acting Branch Chief, Branch 3  
Office of the Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure

A copy of this letter for § 6110 purposes

cc: